

Comm., 793 F.2d 1090, 1094 (9th Cir. 1986). Moreover, there is a presumption of constitutionality under equal protection analysis if the local economic regulation

is rationally related to a legitimate state interest. . . . Rational basis for an economic regulation is established easily and accorded minimal scrutiny. . . . In local economic regulation, wide latitude is given to the governmental entity and only a "wholly arbitrary act" overruns equal protection rational basis.

Silverstein v. Gwinnett Hospital Authority, 861 F.2d 1560, 1564 (11th Cir. 1988) (citations omitted). See also, Cotton States Mut. Ins. Co. v. Anderson, 749 F.2d 663, 669 (11th Cir. 1984).

In applying the rational basis standard to test local economic regulation for equal protection flaws, it has been held that a "distinction [that] reflects the reality of the marketplace [is] therefore . . . not fundamentally irrational." Asociacion de Compositores v. Copyright Royalty Tribunal, 851 F.2d 39, 42-43 (2nd Cir. 1988).

The wide latitude given to states to regulate their local economies under their police powers extends to giving leeway to determine the order and timing of how it will attack a perceived problem. The United States Supreme Court, in New Orleans v. Duke, 472 U.S. 297, 303, 96 S.Ct. 2513, 49 L.Ed 2d 511, 517 (1976), concluded that

[l]egislatures may implement their program step by step . . . in such economic areas, adopting regulations that only partially ameliorate a perceived evil and deferring complete elimination of the evil to future regulations.

Accord, Minn. Ass'n of Health Care v. Minn. Dept. of Public Welfare, 742 F.2d 442, 448 (8th Cir. 1984) ("Consistent with equal protection principles, a legislature may deal with a problem one step at a time, addressing that part of the problem which seems most serious . . . or it may select but one phase of a field of business activity for regulation while neglecting the others.") (Citations omitted).

Equal protection under a rational basis test does not require that the classifications chosen by government to attack a perceived problem be perfect, mathematically precise or guaranteed not to result in any inequality.

The problems of government are practical ones and may justify, if they do not require, rough accommodations - illogical, it may be, and unscientific. A statutory discrimination will not be set aside if any state of facts reasonably may be conceived to justify it.

. . . [T]he Equal Protection Clause does not require that a State must choose between attacking every aspect of a problem or not attacking the problem at all. It is enough that the State's action be rationally based and free from invidious discrimination.

Dandridge v. Williams, 397 U.S. 471, 485-486, 90 S.Ct. 1153, 25 L.Ed.2d 491, 502-503 (1970). (Citations and some material omitted).

B. Application of Law to the Facts

In the Commission's view, the facts clearly show that no one else is similarly situated to SBT. To begin with, the universe of those who could possibly be similarly situated to SBT is small. It is limited to local exchange companies, for only such entities have

even the potential opportunity and incentive to use their monopoly control over the local telephone network to defeat competition in the ES market. However, three circumstances distinguish SBT from all other Georgia local exchange companies: (1) only SBT has been adjudged by the antitrust court and the FCC to actually have the opportunity and incentive to behave anticompetitively in the ES market (See, Part III.A. and B.); (2) only SBT has been the subject of complaints to that effect with regard to its current actual behavior in the Georgia VMS market; and (3) only SBT's opportunity and incentive for anticompetitive behavior and actual anticompetitive behavior has been factually proven to the Commission.

The decision to control SBT's current presence in the ES market is a matter of the Commission's economic regulation of a monopoly telephone utility subject to its jurisdiction and authority, for the purpose of protecting competition in the ES market and protecting the economic interests of the State. Even if there were others similarly situated to SBT, the decision to control SBT's presence in the ES market, arguably reflecting a distinction between SBT and other local exchange companies, is a distinction that reflects the reality of the marketplace. While there are 36 local exchange companies in Georgia, SBT dominates the local exchange arena, controlling some 80% of all the local access lines in Georgia. The reality is that SBT's name recognition and market presence make it the central local exchange company player with respect to the fledgling ES market. The Commission's decision

to control SBT's presence in the ES market in order to promote development of a completely competitive ES market is a legitimate State regulatory goal. Focusing on SBT first, and employing the means described in this order to prevent and deter anticompetitive behavior, are steps rationally related to that legitimate goal. Certainly, selecting SBT for initial investigation and action is rationally related to that goal.

Equal protection does not require the Commission to investigate and control all local exchange companies (regarding anticompetitive behavior in the ES market) simultaneously. Consistent with equal protection principles, the Commission may attack one aspect of this problem at a time. SBT has not shown, and indeed could not show, that the Commission will not investigate and control other alleged local exchange companies' anticompetitive behavior in the ES market where it is brought to the Commission's attention as has SBT's practice with regard to MemoryCallSM service.

VIII.

FINDINGS AND CONCLUSIONS OF FACT, LAW AND REGULATORY POLICY

Based upon the entire record in this case, including but not limited to the specific matters recited in this Order, the Commission makes the following findings and conclusions of fact, law and regulatory policy.

1.

The Commission finds and concludes that MemoryCallSM is an intrastate telecommunications service over which the Commission may

exercise its regulatory authority. See, Section II, incorporated herein by reference.

2.

The Commission finds and concludes, by virtue of taking administrative notice of the relevant federal court decisions in the AT&T divestiture case, that since 1982 the United States District Court for the District of Columbia has continually found, in the context of applying the federal antitrust laws and in the context of exercising its responsibility to weigh public benefit and harm under the Tunney Act, that:

- a. The BOCs possess monopoly control over local telephone service;
- b. BOC monopoly control over local telephone service gives the BOCs the opportunity and incentive to impede competition;
- c. Historically, BOC opportunity and incentive to impede competition through its monopoly control of local telephone systems has been manifested by such actions as (1) discriminating against competitors by denying, delaying or otherwise impeding access to the local network bottleneck, (2) cross-subsidizing competitive services with monopoly service revenues and/or improperly charging expenses and investment of competitive services to monopoly ratepayers and (3) exploiting marketing advantages stemming from the BOCs' local exchange monopoly position.

Saa, Section III.A, incorporated herein by reference.

3.

The Commission finds and concludes, by virtue of taking administrative notice, that the Federal Communications Commission ("FCC") in December, 1983 and in June, 1984 found that, in order to insure that BOC provision of enhanced services will not lead to unreasonable rates because of improper cost shifting or diminish competition in the provision of enhanced services because of other anti-competitive practices, BOC provision of enhanced services must be performed through a separate subsidiary. The FCC found that structural separation would assist control of the BOCs' ability to cross-subsidize competitive offerings and the BOCs' ability to discriminate in the interconnection of competitors' offerings. Saa, Section III.B, incorporated herein by reference.

4.

The Commission finds and concludes that during the trial period for MemoryCall[®], SBT used its monopoly control of the local service network to impede competition in the VMS market by denying MemoryCall[®] competitors appropriate and fair access to the local service network. Saa, Section III.C.1, incorporated herein by reference.

5.

The Commission finds and concludes that during the trial period for MemoryCall[®], SBT used its monopoly control of its local telephone service operations, including specifically but not limited to its monopoly service marketing and billing operations,

to impede competition in the VMS market. See, Section III.C.2, incorporated herein by reference.

6.

The Commission finds and concludes that substantial issues of predatory pricing and cross-subsidy have been raised with respect to MemoryCallSM and that SBT has failed to show by reliable evidence that the price charged by it for MemoryCallSM is a just and reasonable rate, free from predatory pricing and cross-subsidy. See, Section III.C.3, incorporated herein by reference.

7.

The Commission finds and concludes that SBT has the opportunity and incentive to use its monopoly control of the local service network and operations to impede competition in the VMS market. See, findings and conclusions numbers 2 through 6 herein, hereby incorporated by reference.

8.

The Commission finds and concludes that SBT has in fact used its monopoly control of the local service network and operations to impede competition in the VMS market. See, findings and conclusions numbers 4 through 6 herein, hereby incorporated by reference.

9.

The Commission finds and concludes that the regulatory policy it wishes to pursue, which policy it also finds and concludes is a fair, just and appropriate regulatory policy, is to promote the development of the intrastate VMS market to its efficient,

competitive extreme. See, Section IV, incorporated herein by reference.

10. -

The Commission finds and concludes that SBT's opportunity and incentive to use its monopoly control of the local service network and operations to impede competition in the VMS market, and SBT's actual use thereof for that purpose, frustrates attainment of the Commission's regulatory policy of promoting development of the intrastate VMS market to its efficient, competitive extreme. The Commission further finds and concludes that SBT's opportunity and incentive to use, and actual use of its monopoly control of the local service network and operations to impede competition in the VMS market will continue unless effective regulatory controls are developed and implemented to preclude and/or deter such anticompetitive behavior.

11.

The Commission finds and concludes that in order to halt SBT's opportunity and incentive to use, and actual use of its monopoly control of the local service network and operations to impede competition in the VMS market, and to protect the development of a completely competitive VMS market (including protecting individual VMS competitors) until it can become self-regulating, it is proper to place SBT's trial offer of MemoryCallSM on a temporary freeze until the appropriate regulatory controls can be developed and implemented to preclude and/or deter SBT's anticompetitive behavior in the VMS market.

12.

The Commission finds and concludes that SBT's opportunity and incentive to use, and actual use of its monopoly control of the local service network and operations to impede competition in the VMS market has caused and will continue to cause immediate and irreparable harm to development of a completely competitive VMS market and to individual VMS competitors.

13.

The Commission finds and concludes that any harm to SBT that might result from the temporary freeze of SBT's trial offer of MemoryCallSM, is outweighed by the immediate and irreparable harm SBT's uncontrolled presence in the VMS market causes to the development of a completely competitive VMS market and to individual VMS competitors.

14.

The Commission finds and concludes that protection of SBT's ratepayers, promotion of development of the VMS market to a stage of complete competition and protection of the state's telecommunication's infrastructure and economy requires that SBT's trial offer of MemoryCallSM be temporarily frozen while appropriate regulatory controls are designed and implemented. The Commission further finds and concludes that such controls must be designed and implemented on a permanent basis until the VMS market reaches a stage of complete competition where it can self-regulate SBT's presence in the VMS market, notwithstanding SBT's opportunity and incentive to use, and actual use of its monopoly control of the

local service network and operations to impede competition in the VMS market.

IX. -

ORDERING PARAGRAPHS

WHEREFORE, based on the findings and conclusions of fact, law and regulatory policy as stated and supported herein, it is

ORDERED, that SBT's authority to offer MemoryCallSM service on a trial basis is hereby temporarily frozen, such that SBT's provision of MemoryCallSM service is temporarily restricted to those customers who have actually subscribed to MemoryCallSM service on or before the date of this Order.

ORDERED FURTHER, that SBT shall file a complete cost of service study, including all workpapers in support thereof, demonstrating that the price of MemoryCallSM is just and reasonable.

ORDERED FURTHER, that the Commission shall design and implement regulatory controls in accordance with the discussion in Section V herein, at which time the temporary freeze of SBT's offering of MemoryCallSM service shall be reexamined by the Commission.

ORDERED FURTHER, that the Commission shall apply the regulatory framework testified to by the Commission Staff in this case as the general means of regulating SBT's provision of MemoryCallSM service.

ORDERED FURTHER, that in conjunction with applying the regulatory framework testified to by the Commission Staff in this case, the Commission shall develop a standard for determining when


the VMS market has reached a stage of complete competition, so that the Commission may entertain the prospect of fully deregulating SBT's provision of MemoryCallSM service at the earliest appropriate juncture.

ORDERED FURTHER, that jurisdiction over this proceeding is expressly retained for the purpose of entering such further order or orders as the Commission may deem proper.

ORDERED FURTHER, that a motion for reconsideration, rehearing or oral argument shall not stay the effectiveness of this Order unless expressly so ordered by the Commission.

The above by order of the Commission in Administrative Session on May 21, 1991.


WILLIAM J. BUCKNER
EXECUTIVE SECRETARY


BOB DURDEN
CHAIRMAN

6-3-91
DATE

6/4/91
DATE

Audit Report

SOUTHERN BELL TELEPHONE &
TELEGRAPH COMPANY

COST ALLOCATIONS
(REGULATED/NONREGULATED)

AND

AFFILIATED TRANSACTIONS

SEPTEMBER 1994

Utilities Division
Georgia Public Service Commission
and
Snively, King & Associates, Inc.

I. SUMMARY

The primary objective of this audit was to review the relationship between the Company's regulated telephone operations and both its nonregulated activities and the nonregulated operations of its affiliates in order to learn whether Southern Bell's regulated customers are protected from cross-subsidy. Regardless of whether a practice was sanctioned by any particular rule, standard, or procedure, if the practice resulted in a cross-subsidy the auditors were obligated to identify it as such. For example, the Company achieves a significant cross-subsidy in the income tax area which is not precluded by any particular rule.

This audit required the recognition of numerous regulatory and policy issues in addition to accounting matters. It required analyses of the applicable regulatory policies developed in Commission Dockets 3905-U, 3987-U and 4000-U and FCC Docket 86-111 that deal with cost allocation standards, affiliate transactions and related accounting. The audit also required analyses of the purposes and effects of Southern Bell's actions, plus the reasoning that was used to apply the underlying policies in light of those purposes and effects. From the auditors' perspective, these requirements and reasoning were applied within constraints imposed by proprietary agreements and the inability to examine certain material.

As summarized below the auditors identified a number of specific cross-subsidies and cost shifts. The elimination of these

cross-subsidies and cost shifts appears to have taken on considerable urgency in light of Southern Bell's efforts to advance legislative and regulatory plans that would declare all existing rates just and reasonable and apparently eliminate any regulatory oversight of costs.

This report is divided into five parts. This Summary is Part I; Part II relates to the history of Commission activity in the area of cost allocations and affiliate transactions. Part III contains detailed discussion of the auditors' twenty-seven findings categorized into five issue areas -- tax allocation, MemoryCall[®], purchasing, cost allocations and affiliate transactions.

Tax Allocation

Finding Nos. 1 through 7 and 27 deal with the Company's allocation of tax benefits. The auditors found that many of these benefits result in cross-subsidies from regulated operations to nonregulated services and from Southern Bell to BellSouth affiliates. The auditors offer recommendations that will provide a fair and equitable sharing of these tax benefits.

MemoryCall[®]

Finding Nos. 8 through 10 deal with the Company's provision of MemoryCall[®] service. During the course of the audit it became clear that the Company's construction program should be regularly audited for proper assignment between regulated and nonregulated

activities and that Right-to-Use fees should be directly assigned whenever possible.

In June, 1991 the Company began to add MemoryCall¹ costs to regulated operations in the Georgia Surveillance Report. It did not identify these costs in the Surveillance Report and it provided no official notification, tariffs or cost support. The auditors recommend the Company be reprimanded for these failures.

Purchasing, Warehousing and Transfers

Finding Nos. 11 through 13 address purchasing, warehousing and transfers. Two primary issues emerged: (1) cost shifts from competitive to noncompetitive services and (2) a cross-subsidy of nonregulated customer premises equipment ("CPE") by regulated operations. The cost shifts from competitive to noncompetitive services are related to a 1990 switch price restructure negotiated between Southern Bell and AT&T which appears to have inflated noncompetitive service costs and reduced competitive service costs. The auditors recommend that the Commission investigate the implications and effects of this price restructure.

The cross-subsidy of nonregulated CPE by regulated operations resulted from the inclusion of unprofitable CPE in BellSouth Services's ("BSS") operations and the consequent inclusion of those results in regulated operations in the Company's Surveillance Report. The auditors recommend a rate base deduction. The Company should also be reprimanded for its failure to inform the Commission

that the BSS add-back included unprofitable, obsolete, nonregulated business CPE.

Cost Allocation

Finding Nos. 15 and 16 deal with cost allocations between regulated and nonregulated services. The auditors found the Company generally to be in compliance with Part 64 of the FCC rules. However, assuming continued regulatory oversight of the Company's costs, audit scrutiny of these cost allocations will become more critical as the Company's nonregulated operations increase. The auditors recommend the use of positive time reporting for BellSouth's and Southern Bell's Legal Departments to ensure that each individual is held more directly accountable for how his or her time is charged.

Affiliate Transactions

Finding Nos. 17 to 27 identify several issues and cross-subsidies in connection with affiliate transaction rules and cost allocation standards. The auditors recommend increased scrutiny of affiliated lease transactions (Finding Nos. 17 to 20). The auditors also recommend an adjustment to the Surveillance Report interest synchronization adjustment to reflect interest received from advances to affiliates (Finding No. 21). Finding No. 22 recommends that the Commission increase its audit scrutiny of the Company's CPE-related transactions, and is particularly relevant in light of Finding Nos. 3 and 12. Finding Nos. 23 to 26 recommend

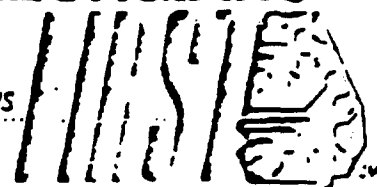
specific cost allocation procedures. Of particular significance is the recommendation to define "substantial third party sales" as meaning that 75 percent or more of the sales are to non-affiliated companies.

Finding No. 27 deals with affiliated transactions between nonregulated domestic and foreign affiliates. It recommends referral of this finding to the IRS International Examination Branch and the Georgia Department of Revenue Income Tax Division for further investigation.

Finally, Finding No. 14 explains why Southern Bell's recent legislative and regulatory initiatives increase the urgency of eliminating subsidies found in this audit.

GEORGIANS

FORGING AN INFORMATION ROUTE THROUGH STATEWIDE TELECOMMUNICATIONS



A Proposal By
BellSouth Telecommunications, Inc.
June 22, 1994

11/2/85

Georgians FIRST

A Georgia Price Regulation Proposal

I. PREFACE

On the effective date of this plan, BellSouth Telecommunications, Inc. (Southern Bell) shall be subject to a price regulation plan in Georgia. The elements of the plan shall be as set forth in detail in the following paragraphs and sections.

II. DEFINITIONS

(a) Basic Services: Basic Services are those services required to provide flat rate basic local exchange service to residential and single-line business customers. Basic local exchange service means the service comprised of an access line and dial tone provided to the premises of these customers for the transmission of two-way interactive switched voice grade communication for usage within the subscriber's local calling area. (See Appendix A Attachment, para. 1).

(b) Commission: The Georgia Public Service Commission.

(c) Interconnection Services: Interconnection Services are those services which provide access to Southern Bell's local exchange or toll network for the purpose of enabling another telecommunications provider to originate or terminate telecommunications services. (See Appendix A Attachment, para. 2).

(d) Non-Basic Services: Non-Basic Services include all other services currently offered by Southern Bell which have not been classified as Basic or Interconnection

1/10/01

Services. These services can be described as optional or discretionary services. (See Appendix A Attachment, para. 3).

(e) Gross Domestic Product-Price Index: Gross Domestic Product-Price Index means the gross domestic product fixed weight price index calculated by the United States Department of Commerce.

(f) New Service(s): New services means a function, feature, capability, or combination of such which is not currently offered by Southern Bell in Georgia.

(g) Tariff: Tariff means the schedule or other writing filed with the Georgia Public Service Commission that describes the rates, terms, and conditions of certain telecommunications services provided by Southern Bell.

(h) Telecommunications Company: Telecommunications company means any person, firm, partnership, corporation, association, or governmental entity offering telecommunications services for hire or compensation.

(i) Telecommunications Services: Telecommunications services means the authorized services offered to customers for the transmission and utilization of two-way interactive communications and associated usage.

(j) Universal Service Provider: Universal service provider means an incumbent local exchange company which is obligated to provide basic local exchange service in all of its local calling areas in response to reasonable requests for such service and which, in consideration of such obligation, may establish rates for interconnection services as provided in this article.

III. PRICE REGULATION

(a) From the effective date of this plan the Commission will regulate the prices of the services provided by Southern Bell to the public as provided in this plan, rather than regulating the earnings of the Company in its entirety.

(b) On the effective date of this plan, all existing rates, terms and conditions for the services provided by Southern Bell contained in its then existing tariffs and contracts are deemed just and reasonable.

(c) Rates for basic services existing on the effective date of this plan shall be the maximum that Southern Bell may charge for such services for a period of five years from the date of approval of this plan. This provision shall not apply to rate adjustments authorized as a part of the Commission's order dated June 2, 1994 in Docket No. 4684-U In Re: Atlanta Metro Extended Area Service Expansion.

(d) After the expiration of this five year period, the change in basic service rates, in the aggregate, is capped at the level of inflation. Southern Bell is authorized to adjust the cap on an annual basis, at a date selected by Southern Bell. The adjustment for the first year after the expiration of this time period, and each succeeding year, shall not exceed the change in the GDP-PI from the immediately preceding year. Rate adjustments for basic services, in the aggregate, shall not exceed the established cap. Rates for individual services or groups of services in the basic services category may be increased or decreased by varying amounts as long as the overall rate changes do not exceed the cap. If rates are not adjusted by the full amount allowed by the cap in a particular year, the amount not used may be carried over to future years.

(e) Southern Bell is authorized to set the rates, terms and conditions for interconnection services based on market considerations. The Company may establish flexible pricing options, including but not limited to volume discounts for all interconnection services.

(f) Southern Bell is authorized to determine the prices, terms and conditions for all non-basic services based on market considerations. These services may be provided by Southern Bell through tariffs, written contracts or other commercially reasonable means.

(g) Notwithstanding the provisions of Subsections (c) and (d) of this Section, the financial impact of governmental mandates which apply specifically and exclusively to and have an impact on telecommunications companies, including, but not limited to, separations changes ordered by the Federal Communications Commission, may be recovered through an adjustment to rates for basic services, or from other rates as designated by Southern Bell. Within 60 days of the occurrence of such changes, Southern Bell shall notify the Commission of its intent to adjust its basic service rates. Such notice shall provide a schedule of the adjusted rates and the effective date of the adjusted rates.

(h) After the effective date of this plan, Southern Bell shall not be required to seek regulatory approval of its depreciation rates or schedules in Georgia nor will it be required to produce intrastate financial statements for Georgia. Nothing in this subsection will be construed to prevent the Commission from requiring that Southern Bell demonstrate that any rate change comports with the requirements of this plan.

IV. TARIFFS

(a) Except as provided in Section III(c) above, Southern Bell may file new or revised tariffs with the Commission covering any service provided by the Company.

(b) Any tariff covering any new service shall be presumed to be valid and shall be effective upon 14 days notice. Any changed tariff reducing the price of an existing service or not affecting the existing rate shall be effective on 7 days notice. Any changed tariff increasing the rates for an existing service shall be effective on 14 days notice.

Southern Bell will not change the price of individual services, absent a compelling market need, more than one time in each calendar year.

(c) Southern Bell may file a tariff reclassifying a service from one service category to another. Such tariffs shall be presumed valid and shall be effective on 14 days notice.

In the event that the Commission chooses to do so, it may investigate to determine whether such reclassification was appropriate. Such investigation shall not delay the implementation of the reclassification, but if the Commission determines the reclassification to be in error, it may order a change, subject to the appropriate administrative and judicial reviews.

V. UNIVERSAL SERVICE PROVIDER

Nothing in this plan shall limit or abrogate Southern Bell's universal service obligation under existing law nor authorize it to abandon basic service to any of its local calling areas without the approval of the Commission.